PSG Wealth

# Weekly Investment Update

30 November 2016

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## Healthcare providers expanding offshore - pg. 3

## Market moves

| Performance: 18/11/2016 to 24/11/2016 | Return (Cumulative) |
|---|---|
| Local Markets | |
| All Share TR ZAR | -0.07 |
| Ind/Financials TR ZAR | -0.18 |
| Ind/Industrials TR ZAR | -1.48 |
| Financials&Indl 30 TR ZAR | -1.07 |
| Ind/Basic Materials TR ZAR | 3.30 |
| Gold Mining TR ZAR | -10.98 |
| SA Listed Property TR ZAR | -1.65 |
| Beassa ALBI TR ZAR | -0.06 |
| Commodities | |
| Oil Price Brent Crude PR | 5.40 |
| LBMA Platinum AM PR USD | -2.65 |
| Gold London AM Fixing PR USD | -3.63 |

## The week ahead

### Domestic

01 Dec Barclays manufacturing PMI

02 Dec S&P Global rating review

### International

02 Dec EA: PPI

02 Dec US: Non-farm payrolls

## Macro

### South Africa

The unemployment rate increased sharply to 27.1% in the third quarter of 2016. This was largely due to discouraged workers re-entering the labour market. Over the past year South Africa has added a mere 5000 jobs.

### France

The economy advanced 0.2% quarter-on-quarter in September 2016, compared to a 0.1% contraction in the three months to June. While investment and government spending rose, household consumption stagnated and net external demand contributed negatively to the growth.

### Japan

Retail sales edged down 0.1% year-on-year in October, following a downwardly revised 1.7% drop in September. It is the eighth straight annual drop, although lower than expectations of a steeper 1.2% decrease.

## Markets*

### Best performer

For the week was the Lewis Group with a return of 18%. The Foschini Group was second with a 12% return for the same period.

### Worst performer

Lonmin and Sibanye Gold were the worst performers for the week, both with a loss of 10%. Followed by Royal Bafokeng Platinum with an 8% drop for the week.

### Sectors

The best performing sector for the week was electrical equipment with a return of 8% for the week. The media sector was the worst performing sector with a 5.7% loss.

*Disclaimer: Total weekly returns based on closing values from Monday to Monday.

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## Macro note

### S&P downgrade possible, but not our base case

We foresee a 40% probability that the country could be downgraded by S&P Global Ratings later this week.

Earlier this year the S&P Global Rating agency warned that further political instability in South Africa would be a risk to South Africa's sovereign credit rating. However, political events, particularly in the past month, were positive for South Africa's economic and credit-ratings outlook. The withdrawal of charges against finance minister Pravin Gordhan, a good medium-term budget and the release of the public protector's report on state capture boosted the faith in our democratic institutions and highlighted our government's commitment to fiscal consolidation. This could mean greater confidence, greater investment and a more vital economic outlook. In Moody's review released on 25 November, the rating agency kept SA's sovereign rating unchanged. Fitch revised its outlook from stable to negative, but kept its rating unchanged at BBB-. Both agencies cited political risk, standards of governance and policy-making as future risks.

We expect our sovereign credit rating to remain at BBB- with a negative outlook. As such we don't expect any extreme market volatility to occur. If our base case materialises, then bond yields should stay relatively stable, while the rand could strengthen marginally as further uncertainties wane. On a further positive note we envisage equity returns to continue to outperform inflation and cash in the long term.

In the event of a possible downgrade, junk status may not necessarily be as devastating to the markets as generally expected, given markets have already priced in much of the bad news. The bad news being that junk status increases the governments' cost of capital which will place additional pressure on the national budget, and ultimately taxes. In addition, corporate financing cost will also increase, which places pressure on corporate earnings and economic growth. One needs to be aware that SA's credit rating is not the only factor that will influence its borrowing costs. Commodity prices, global sentiment towards emerging markets, currency appreciation and the prospects of interest rate cuts could all impact a country's borrowing costs. Take Brazil for example. S&P cut this South-American country's rating to two notches below investment grade in February, but that government's long-term borrowing cost actually declined, from 17% to 11%.

### South Africa's credit rating

| Agency | Rating | Outlook | Date |
|---|---|---|---|
| Fitch | BBB- | negative (25 Nov 2016) | 04 Dec 2015 |
| S&P | BBB- | negative | 04 Dec 2015 |
| Moody's | Baa2 | negative | 25 Nov 2016 |

Source: Trading Economics

### PSG Wealth predictions for S&P rating decision

| | BEAR | BASE | BULL |
|---|---|---|---|
| | S&P downgrades us to junk status | S&P keeps our rating of BBB- and outlook at negative | S&P changes our outlook from negative to stable |
| | 40% | 50% | 10% |
| IMMEDIATE | • Domestic markets sell-off<br>• Bond yields shoot up<br>• Rand depreciates to beyond 4+ standard deviation from purchasing power parity (PPP) | • No extreme market volatility<br>• Bond yields relatively stable<br>• Currency strengthens marginally as uncertainty subsides | • Market sentiment improves<br>• Equity and bond markets rally<br>• CDS spreads decline<br>• Rand strengthens to below 3 standard deviations from the PPP mean |
| NEAR | • Rand recovers some initial losses to below 4 standard deviations from the PPP mean<br>• Mixed results in equity markets, that causes stock pickers with active management strategies to outperform | • Rand strengthens to below 3 standard deviations from the PPP mean<br>• Equity returns outperform inflation and cash, as an asset class, fundamentals overpower sentiment over the long term | • Rand continues to strengthen as cost of capital is reduced in light of lower sovereign risk and uncertainty<br>• Equity returns surprise to the upside as sentiment continues to improve |
| LONG TERM | • Rand strengthens to below 3 standard deviations from the PPP mean as inflation differential fundamentals overpower sentiment over the long term<br>• Equity returns outperform inflation and cash, as an asset class, fundamentals overpower sentiment over the long term | • Equity returns continue to outperform inflation and cash | • Equity returns continue to outperform inflation and cash |

Source: PSG Wealth research team

# Market note

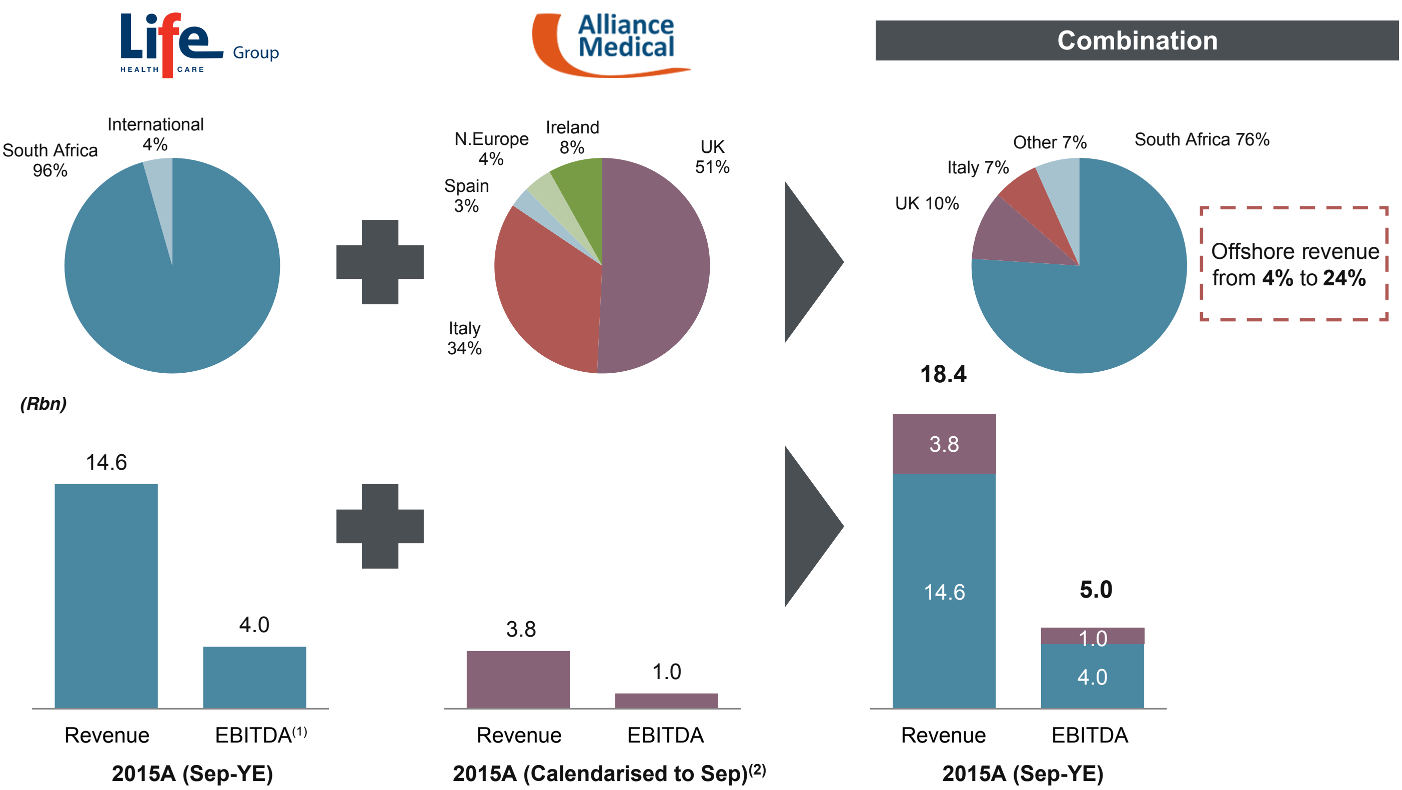
## Healthcare providers expanding offshore

The Life Healthcare Group (LHG) is expanding offshore in an effort to mitigate the constrained and mature domestic market. This healthcare provider entered into an agreement to acquire a 95% stake in Alliance Medical Group (AMG) for 553m pounds and a deferred cash consideration of up to 40m pounds dependant on AMG's financial performance to 31 March 2017. Meaning a fifth of its earnings would come from abroad.

Details on where LHG will get the funds are still unclear. Independent investment analyst, Mark Ingham, told Biznews that LHG: "would probably need to raise an additional R7bn in equity, assuming new shares were issued at R30. Entailing the issue of 232m shares. They have 1.058m shares in issue at the moment, so on that assumption it would mean that there would be a 22% increase in the total number of issued shares, in order for them to pay for the deal."

He adds it will be a mixture of about 65% equity to 35% debt. Extra interest from the debt that needs to be raised will be about R3.7bn. He calculated the after-tax and interest position (assumed pro-forma earnings of R2.3bn after the deal and latest earnings released of R1.9bn) and found the pro-forma earnings would be 180c per share. Meaning the debt would be EPS neutral. "In other words, it wouldn't be detracting from earnings per share, on that basis."

## Life Healthcare before and after the acquisition




Source: Life Healthcare investor presentation November 2016

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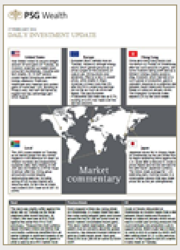
## Previous publications

### Daily




30 November 2016

### Weekly


| | | | |
|---|---|---|---|
| 16 Nov | 17 Aug | 01 Jun | 23 Mar |
| 09 Nov | 10 Aug | 25 May | 16 Mar |
| 02 Nov | 02 Aug | 18 May | 09 Mar |
| 26 Oct | 27 Jul | 11 May | 01 Mar |
| 12 Oct | 13 Jul | 04 May | 23 Feb |
| 05 Oct | 06 Jul | 26 Apr | 11 Dec |
| 28 Sep | 29 Jun | 20 Apr | 20 Nov |
| 14 Sep | 22 Jun | 12 Apr | 16 Nov |
| 07 Sep | 15 Jun | 05 Apr | |
| 31 Aug | 08 Jun | 30 Mar | |

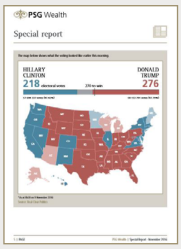
### Monthly


| | | | |
|---|---|---|---|
| Nov | 2016 | Dec | 2015 |
| Oct | 2016 | Nov | 2015 |
| Sep | 2016 | Oct | 2015 |
| Aug | 2016 | Sep | 2015 |
| Jul | 2016 | Aug | 2015 |
| Jun | 2016 | July | 2015 |
| May | 2016 | Jun | 2015 |
| Apr | 2016 | May | 2015 |
| Mar | 2016 | | |
| Feb | 2016 | | |

### Quarterly

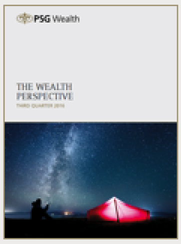

| | |
|---|---|
| Spring | 2016 |
| Winter | 2016 |
| Autumn | 2016 |
| Summer | 2015 |
| Spring | 2015 |

### Special Reports




- US election
- Market PE's
- Domestic local government elections
- Brexit vote
- Cash vs Long-term instruments
- S&P June 2016 rating decision explained
- Fed Dec 2015 interest rate hike
- Impact of political moves on investments
- FoF fees small compared to actual gains
- SARB hikes rates
- Weak PMI support foreign diversification

### Wealth Perspective




| | |
|---|---|
| Sep | 2016 |
| Jul | 2016 |
| Apr | 2016 |
| Jan | 2016 |
| Oct | 2015 |
| Jul | 2015 |